ST 99-34
Tax Type: Sales Tax
Issue: Separately Stating Tax/Separately Contracting For Sales v. Service Issues

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	**No. 98-ST-0000** **IBT # 0000-0000** **NTL # SF-0000000000000**
v.	**NTL # SF-0000000000000**
"IT'S YOUR LOSS, INC." **Diet Emporium,** **Taxpayer**	**Kenneth J. Galvin** **Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Ms. Ariadne Beldecos on behalf of the taxpayer, Mr. Charles F. Hickman, on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to "It's Your Loss, Inc.'s" (hereinafter "taxpayer") protest of Notice of Tax Liability (hereinafter "NTL") No. S F 970000000000 and No. S F 9700000000001 issued by the Department of Revenue (hereinafter the "Department") on October 6, 1997, for retailers' occupation and related taxes. An evidentiary hearing was held on January 12, 1999, as to the following two issues remaining in controversy: 1) whether the Department erred in calculating and assessing retailers' occupation tax (hereinafter "ROT") on the transfer of pamphlets; and 2) whether taxpayer owed tax on the sale of tangible personal property

where the selling price allegedly included the tax and the tax was not separately stated. Oral testimony at the hearing was provided by Mr. Richard Mosquera, Revenue Auditor for the Department, Ms. "Jane Doe", Service Manager for the taxpayer and Ms. "Mary Roe", Service Provider for the taxpayer. Following submission of all evidence and a review of the record, including briefs filed by the Department and the taxpayer[1], it is recommended that the first issue be resolved in favor of the taxpayer and the second issue be resolved in favor of the Department. In support thereof, the following "Findings of Fact" and "Conclusions of Law" are made.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of an "Audit Correction and/or Determination of Tax Due," dated July 25, 1997, for $15,289, covering the period January 1, 1993, through November 30, 1993, and an "Audit Correction and/or Determination of Tax Due," dated July 25, 1997, for $38,928, covering the period December 1, 1993, through June 30, 1996. Dept. Ex. No. 1.

Findings of Fact (Issue 1):

2. Taxpayer would charge members $11 or $13 per week for one session. This amount included a weigh in, a meeting in which a specific topic or habit change was discussed and a pamphlet. Members would receive one pamphlet each week for the first eight weeks. Tr. pp. 12-13, 45, 52-53; Taxpayer's Ex. No. 1.
3. Pamphlets are not sold to members or nonmembers. A person must join taxpayer in order to get the pamphlets. If a member loses a pamphlet, it is replaced. If taxpayer changes programs,

[1] Taxpayer's Brief at page 2 states: "That is each location has a cash box and tally sheets (examples of which were entered into the record as Exhibits V and VI)." The transcript contains no record of "Exhibits V and VI." On page 57 of the transcript, taxpayer's Exhibits 1 through 4 were admitted into evidence. The tally sheet was admitted as Exhibit 2. There is no record of a cash box having been admitted as evidence.

lifetime members are given the current pamphlets as are the members who are continuing to lose weight. Tr. pp. 43-44, 54.

4. At year-end or when programs are updated or changed, old pamphlets are destroyed. Tr. p. 44.
5. The Revenue Auditor determined that the pamphlets were tangible personal property and that the transfer of the pamphlets to members was a ROT transaction. Tr. p. 13.
6. In the course of the audit, the Revenue Auditor came across an invoice for pamphlets for $8,600. Based on the auditor's experience, he estimated that the selling price of a pamphlet would usually include a markup of from 50% to 200%. The auditor used a 100% markup and estimated that each pamphlet sold for 6.5 cents, and resulted in a total tax due of $35,084. Tr. pp. 13-14, 20, 26; Dept. Ex. No. 2.
7. Taxpayer has hundreds of locations in Illinois. ROT is based upon the location where the tangible personal property is sold. The auditor selected nine of the taxpayer's locations, each with a different tax rate, for his estimate of total tax due. Tr. pp. 12, 15, 30; Dept. Ex. No. 2.

Findings of Fact (Issue 2):

8. Taxpayer did not use cash registers at its locations. The employees worked from a cash box. No change was kept at the locations. Members could write checks, pay cash or use credit cards. Tr. pp. 16, 41; Taxpayer's Ex. No. 2.
9. When the taxpayer sold products, an amount was backed out of the sales price under the assumption that the sale price of the product included tax. Taxpayer filed timely returns indicating sales price and tax paid. Tr. pp. 15-16, 32.
10. Customers received a stamp when they purchased a product. The stamp was pulled off of a tape and pasted on the membership booklet. The stamp contained a code as to what type of

member (lifetime or current) made the purchase and the purchase price that was collected. The stamp did not separately itemize sales tax. Tr. pp. 47-48.

11. No signs were posted by the taxpayer indicating that the tax was included in the purchase price of the products being sold. No invoice or other document was given to the purchaser to indicate that tax was included in the purchase price. Tr. pp. 48-49, 55-56.
12. Purchasers would be told that sales tax was included in the sales price, if they asked. Tr. pp. 49, 53, 55.
13. Taxpayer sold food and tangible personal property. The tax rates of each depend on the tax jurisdiction, with food taxed at 1% to 2% and tangible personal property taxed at 6.25% to 8.75%. Tr. pp. 16-17.
14. The auditor determined that 72% of the amount collected was from merchandise and 28% was from food. Tr. p. 17.
15. The auditor disallowed the entire amount collected. The Department's position was that the amount that the taxpayer remitted as tax was actually part of the sale price, with tax still to be collected. Tr. pp. 17-18.

Conclusions of Law (Issue 1):

The first issue identified as being in controversy concerns the ROT which the Department determined to be due on the transfer of the tangible personal property, in this case pamphlets, by the taxpayer to its members at the weekly meetings. The taxpayer did not collect or remit tax on the transfer of these pamphlets. The Department determined that the transfer of the pamphlets constituted a retail transaction, and then estimated the cost price of the pamphlets during the period sampled and marked up the cost price by 100%. The ROT deficiency attributable to the transfer of the pamphlets is $35,084.

The taxpayer did not dispute the dollar amount of the adjustment but took issue with the characterization of the transfer of the pamphlets as a retail sale. The taxpayer believes that use tax should be imposed on the pamphlets based on the cost price of the tangible personal property. Tr. p. 6. The parties have stipulated that if the transfer of the tangible personal property is determined to be incident to a sale of service, then the tax to be imposed would be one half of the amount determined to be due by the auditor under the ROT Act. (Department's Brief p. 1).

The Department cites and relies on Dinner Theatre Associates v. Department of Revenue, 139 Ill.App.3d 911 (3d Dist. 1985). In Dinner Theatre, the taxpayer charged a single admission price to its customers who received a meal and a theatrical production. The Department determined that the meal was equal to one half of the admission price, and was a sale at retail of tangible personal property subject to ROT. The taxpayer argued that it was primarily engaged in the sale of entertainment and the food was incidental to the presentation of the entertainment. The court found that the taxpayer was "involved in a taxable business of both selling goods at retail and in the furnishing of a service" and that the allocation of ROT to one half of the ticket price was fair and correct. *Id*. at 912.

The Department also relies on Private Letter Ruling ST-97-0003 to support its position. In this ruling, the Department found that a portion of the charge for a professional education seminar must be allocated to the written materials distributed during the seminar. The materials were designed to facilitate discussions and were used exclusively at scheduled presentations of the course. The materials were not designed for independent use and could not be purchased separately. It was estimated that the materials constituted 18% of the annual aggregate gross receipts. The Department concluded, based on the facts provided by the taxpayer requesting the ruling, that the

course materials were subject to ROT. The Letter Ruling is unclear and it has not been accorded any weight in this Recommendation.

Taxpayer cites and relies on American Airlines, Inc. v. Department of Revenue, 58 Ill.2d 251 (1974), where the Court held that the meals American served to its passengers were incidental to American's primary air transportation service and, as such, were not sales at retail subject to ROT. The Court found that when American purchased the meals, it was not for purposes of resale. The meals were provided as a "commercial amenity," which was "necessary in the competitive field of air transportation." There was not a separate charge for the meals served and the meal was included in the price of the ticket purchased. A passenger telling a ticket agent that he did not desire a meal would not receive a reduction in the price of his ticket. The Court noted further that the meals amounted to three tenths of one percent (.003) of total costs.

The facts in the instant case are similar to American Airlines. American and taxpayer are transferring tangible personal property to customers in the course of providing a service. The relation of the cost of the tangible personal property to the service is minimal; less than one half of one percent (.005) for the pamphlets, and three tenths of one percent (.003) for the meal. On cross-examination, the auditor agreed that the cost of the pamphlets was not a material amount. Tr. p. 26. This differs from Dinner Theatre, in which the cost of the dinner was 50% of the admission price. In Dinner Theatre, the court noted that the "relationship between the meal cost and the ticket price is substantial." Dinner Theatre at 913. In contrast, the cost of the pamphlets and the meals served by American are insignificant to the total cost of the service being provided.

In addition, the pamphlets and the meals were not sold apart from the service provided. A person must join taxpayer to get a pamphlet. Tr. pp. 43. A person does not get a meal on American unless they take a flight. Similarly, taxpayer continues to charge $13 per week after week 8, even

though no pamphlets are distributed. (Taxpayer's Brief, p. 2). A passenger who does not desire a meal on American would not receive a reduction in the price of his ticket. In Dinner Theatre, the court noted that it would be "unreasonable" to believe that patrons would be charged the same or nearly the same admission price if dinner was not available. In American Airlines, passengers were charged the same fare on flights between the same points even when meals were not served.

I have concluded that the pamphlets distributed by taxpayer, similar to the meals served by American, are incidental to the primary service being provided. Accordingly, the transfer of the pamphlets is not a retail sale and the Department erred in assessing ROT on the transfer. The correction of returns relative to this issue should therefore be amended to show one-half of the liability as use tax, as agreed to by the parties.

Conclusions of Law (Issue 2):

The second issue in controversy concerns the assessment attributable to the tax on the gross receipts of food and merchandise sold by the taxpayer. The auditor testified that when the taxpayer sold these products, an amount was backed out of the sales price under the assumption that the sales price of the product included tax. The taxpayer would then pay ROT on this reduced amount. The Department disallowed taxpayer's determination of tax due which amounted to an assessment of $2,921 for food and $5,480 for merchandise.

Under the Retailers Occupation Tax Act (hereinafter "ROTA") a retailer must pay tax for the privilege of selling within Illinois. 35 ILCS 120/1 *et seq.* ROTA imposes a tax based on a percentage of the retailer's gross receipts from the sale of tangible personal property. 35 ILCS 120/2-10. Gross receipts include "the total selling price," but do not include amounts that a retailer collects under the Use Tax Act (hereinafter UTA). 35 ILCS 120/1.

ROTA and UTA are complementary statutes. Whereas ROTA imposes a tax upon persons engaged in the business of selling tangible personal property at retail, UTA imposes a tax upon the privilege of using tangible personal property purchased at retail from a retailer. Brown v. Zehnder, 295 Ill.App.3d 1031 (1st Dist. 1998). UTA relieves Illinois retailers who collect tax on a transaction from paying ROT on that transaction. United Air Lines, Inc. v Johnson, 84 Ill.2d 446 (1981). A retailer may reduce its liability under ROTA by the amount of use tax collected.

When collecting use tax, the statute requires that the tax "be stated as a distinct item separate and apart from the selling price of the tangible personal property." 35 ILCS 105/3a. 86 Ill.Adm.Code § 130.405(g) states that if the seller does not state the use tax to the purchaser as a separate item from the selling price in accordance with the procedures described in 86 Ill.Adm.Code § 150.1305, the failure to state the tax separately will "create a rebuttable presumption that the tax was not collected." Section 1305 provides that a retailer can prove compliance with the requirements of stating the use tax as a separate item from the selling price by showing the tax separately on invoices or sales tickets that are issued to the customers, by having the tax shown separately from prices on a copy of the cash register tape, or by publicly posting an appropriate sign.

Ms. "Doe" and Ms. "Roe" testified that no invoice or other document was given to the purchaser to indicate that the tax was included in the sales price of the products sold. Tr. pp. 55-56. No signs were posted by the taxpayer indicating that the tax was included in the purchase price. Tr. p. 48. Although customers received a stamp when they purchased a product, the stamp contained the purchase price, but did not separately itemize the sales tax. Tr. p. 48. A purchaser would only be aware that sales tax was included in the sales price if they asked. Tr. pp. 49, 53, 55. Based on the testimony at the evidentiary hearing, I have concluded that the taxpayer did not comply with the

requirements of Section 1305. The taxpayer's failure to state the tax as a separate item from the selling price creates a rebuttable presumption that the tax was not collected. 86 Ill.Adm.Code § 405(g).

This presumption is overcome if the "seller can produce documentary evidence which shows that the tax or its equivalent was in fact collected." 86 Ill.Adm.Code § 405(g). At the evidentiary hearing and in its brief, taxpayer cited Sunnyland Cabinet and Millwork, Inc. v. Department of Revenue, 52 Ill.App.3d 25 (3d Dist. 1977). Sunnyland held that a taxpayer's noncompliance with the Department's use tax regulations raised a rebuttable presumption that the tax was not separately stated and not collected from the customer. If the taxpayer can overcome the presumption with evidence of compliance, then the Department is prohibited from assessing additional tax for failure to comply with the regulations. In Sunnyland, the "undisputed evidence" indicated that the taxpayer informed each customer of the amount of tax separate from the cost of the merchandise. *Id*. at 29. The court found that the deficiency assessment was erroneous because the taxpayer introduced evidence of its business procedures which established that all taxes due were in fact separately and correctly stated, collected and remitted. *Id*. at 28.

In the instant case, in order to establish that it collected and remitted all taxes, taxpayer had admitted as evidence at the hearing a "Sales Tax Register" for April 28, 1996, to May 25, 1996, which shows sales taxes computed separately from gross sales price. Taxpayer's Ex. No. 4. However, the auditor testified that the tax was determined by backing out an amount from the sales price under the assumption that the sales price of the product included the tax. Although the "Sales Tax Register" shows that tax was calculated, the auditor testified that it was calculated by "backing out the tax." Tr. p. 32. Unlike the taxpayer in Sunnyland, taxpayer is unable to show any records

where the tax was separately and correctly stated, and thus has failed to present sufficient evidence to rebut the presumption of noncompliance.

Finally, the taxpayer notes in its brief that 86 Ill.Adm.Code § 150.1305 requires that a retailer separately state to the purchaser the tax collected on the sales transaction "unless the Department finds that it is not possible, under the facts of the case, for the retailer to collect the tax from the purchaser as a separate item from the selling price." 35 ILCS 105/3-a states specifically that "where it is not possible to state the sales tax separately in situations such as sales from vending machines or sales of liquor by the drink the Department may by rule exempt such sales from this requirement so long as purchasers are notified by a sign that the tax is included in the selling price."

Taxpayer argues that its locations in Illinois are "manually operated having nothing more than a cash box and a tally sheet to collect and report sales transactions at each class location." No cash or change is available requiring that class coordinators transact in whole dollars wherever possible. Taxpayer's Brief, p. 7. Taxpayer argues that this makes it "impractical if not impossible" for class coordinators to provide customers at the time of sale with the exact amount of ROT collected on the transaction. Taxpayer's Brief p. 7.

Taxpayer has made a choice to use a cash box, rather than a cash register at its locations. Taxpayer has made a choice not to supply the class coordinators with change, so that they must transact in whole dollars. I am unable to conclude that it is "not possible" for the taxpayer to collect the tax when relatively insignificant changes would be required to provide customers with the exact amount of ROT collected at the time of the transaction. 35 ILCS 105/3-a identifies two situations where it is not possible to state the sales tax separately: sales from vending machines and sales of liquor by the drink. The taxpayer's decisions not to use a cash register and not to provide

change do not rise to the level of impossibility contemplated in the statute. Moreover, taxpayer is not in compliance with the requirement in 35 ILCS 105/3-a that a sign be posted notifying sellers that the tax is included in the selling price.

Accordingly, the Department's determination of ROT due of $2,921 for food and $5,480 for merchandise is upheld in its entirety.

ENTER:

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Kenneth J. Galvin

November 23, 1999